

Case 9

Walkers Lodge

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Overview of the Company

Walkers Lodge is a traditional farm house, over 100 years old. It's situated in a beautiful location in Co. Wicklow, near Roundwood Village, on a 30-acre site on a working dairy farm with walking trails on the farm and in the surrounding areas. The owners, John and Mary Summers, have renovated 15 rooms in their house with the aid of grants and created a bed and breakfast business which operates seasonally for six months of the year, from April to the end of September. The Lodge was classified by Fáilte Ireland as a 4-star bed and breakfast in the latest edition of their *Discover Ireland* guidebook to accommodation. The Summers mainly use the farm for milk and cheese-making activities, as well as growing a variety of vegetables and cultivating summer fruits in the orchards. However, the farm is extremely profitable, turning in a profit of about €120,000 per annum due to rental income from grazing cows, as well as the sales of milk, cheese, fruit and vegetables to the local farming co-operative.

The Issues

They have been paying an external accountant, Ted Toner, for compliance services since they bought the farm 16 years ago and they continued to use his firm when they decided to launch the guesthouse and walking business six years ago. Ted's work involves preparing a set of accounts for Walkers Lodge Ltd incorporating both the farm and the guesthouse businesses and doing the tax calculation and auditing the accounts. Due to new regulations promulgated by the EU, under Statutory Instrument (S.I.) No. 308 of 2012, small companies had their audit exemption thresholds raised as follows:

- balance sheet total from €3,650,000 to €4,400,000
- amount of turnover from €7,300,000 to €8,800,000

This means that some accountants will not have to audit their small clients if they have turnover and balance sheet totals less than the above values. Consequently, since 7 August 2012, the external accountancy firms serving small clients will have to look to replace this audit fee income with non-compliance services. Clients will be more likely to pay for non-compliance services from their external accountant, such as business advice and management accounting services, only if they feel these services can add value to their businesses.

The Tasks

Ted Toner is in his late fifties and has employed you, a third-year Accounting and Finance student, as a summer assistant in his office in Roundwood, Co. Wicklow. He wants you to give him “a breakfast briefing on the issue of non-compliance services” given that “you are such a whizz-kid and unlike me, has the time to read the research literature”. Another task he has allocated to you is to help him prepare the half-year accounts for the 2013 season just ended and the forecasted figures for the next three half-years (see data in **Appendix 1**). The forecasting work is new for the firm and he wants you to prepare it carefully, checking the assumptions of the Summers and writing a short interpretive report of what the forecasts reveal. He hopes to progress this type of management accounting work more, as it helps to replace the audit fee income, which is likely to decline, now that many of his small clients will be exempt from the audit requirement. You have started to “cut and paste” some material from the research literature and are frantically trying to make sense of it, to be able to explain it in a memorandum that Ted can understand.

The Summers' Proposal

Ted Toner then asks you for coffee and starts to explain the plans for the Lodge for the next 3 years. The Summers had installed solar panels after the end of the 2013 season to help reduce energy costs. They have been advised that these solar panels will eventually reduce in cost in about six years time, when the stored energy from the sun begins to take effect. They also intend to provide guided walks around the Sally Gap and other scenic areas starting in 2014, using student guides employed on a temporary basis for the season. They hope to attract other walkers to the morning briefing meeting at the Lodge and offer them a full Irish breakfast at €5 charge. The meeting room for the briefing is provided free of charge to attract walkers staying in other accommodation, to the Lodge, as a key meeting area, who will then hopefully create margin for the Lodge by buying breakfast. They also intend to phase out the business executive guest segment as these guests dislike having noise from families staying in the Lodge. A concerted effort is to be made to attract more families and individual and groups of walkers over the next three years. Two new package rates will be launched – a weekend two-night bed and breakfast package rate (W1), aimed at attracting young couples wanting a short rural break with some guided walks, and the other is a three-night mid-week bed and breakfast rate, aimed at the active early retired couples market (W2). The C1 rate will be discontinued in favour of the W1 and W2 rates. Due to an expected increase in guest numbers for the next three years due to intensive marketing efforts by John Summers, a Twitter enthusiast, they will be unable to do the rooms themselves, but will require seasonal cleaners, who can be sourced from the local area.

The Summers feel they will be able to know which guest segments are profitable for them, even with no management accounting information as to the costs of serving the various segments or profitability analyses of these segments. They hope that the families will tend to come in the last three months of the season and that single walkers will come in groups or on their own, in the first 3 months of the season. The package rates are designed to attract occupancy right through the whole season in the mid-week and weekend times. It can be difficult to get mid-week occupancy due to work commitments, so the active retired market is being targeted using the discounted W2 rate. To test his reaction in advance of the breakfast briefing, you quickly finish your coffee and give Ted a brief overview of the research on the role of the accountant in providing non-compliance services to owner manager businesses as set out below.

Recent Research Evidence

Evidence from recent international research found that most owner-managers (OMs) had a long-standing relationship with their external accountant and were for the most part, happy with the compliance services provided, but unsure regarding the competency of the accountant in the non-compliance/advice area. The five most common advice themes were: diligence (i.e., managing and avoiding risks) focus (i.e., remaining alert and avoiding distractions from the core business) and control (i.e., tightening internal controls). Irish research also points to most work done by small and medium firms of accountants for their OM clients to be of the compliance/statutory type with business advice, tax consultancy and financing advice being the top three non-compliance services. However, the lack of industry knowledge was the factor that most weakened the satisfaction rating of the accountant in an advisory capacity (with only a 60% satisfaction rating). There needs to be strong trust between the small and medium-sized local accountancy firm and the client for non-compliance services to be requested. Also, these firms need to improve the efficiency with which they carry out their compliance work so that they then have time to offer non-compliance services and also market themselves better. The accountant must spend time explaining the results to his client in an effective way, because Irish research shows that many clients felt that very little discussion (about how the results came about or how improvements could be made in the future) took place between the accountant and them, once accounts had been prepared. Finally, the latter research implied that younger entrepreneurs did see a benefit to additional non-compliance services on offer and would be willing to purchase these, if they added value to their business.

Required

As a student accountant employed for the summer at Ted Toner's practice in Roundwood, County Wicklow, you have to complete the following tasks:

Question 1

Compute the actual income statement for Walkers Lodge for the season just ended, namely the six months ended 30 September 2013, using a marginal costing format. Comment on the results revealed by the statement.

(20 marks)

Question 2

- (a) Prepare a forecast for the three years 2014, 2015 and 2016, clearly showing your workings and using a marginal costing format for the forecasted income statement.

(25 marks)

- (b) Comment on the Summers' proposal to offer two-night weekend breaks at discounted prices to younger couples and mid-week three-night breaks to early retired couples, both from a profitability and a marketing perspective.

(15 marks)

- (c) Outline also what management accounting information and templates could give helpful business insight to the Summers for the next few years and make reference to relevant literature regarding how tourism and learning networks can help OM's (and accountants) to learn.

(20 marks)

Question 3

Write a short memorandum to Ted Toner, continuing your review of the literature, but carefully summarising what both Irish and international research is saying regarding the need for accountants to offer non-compliance services to small businesses. You may consult the reports on the role of the accountant and services to small businesses on the websites of the professional accountancy bodies, to get you started. Give some guidance to Ted as to where he might find useful references on this topic.

(20 marks)

Total 100 marks

APPENDIX 1: REVENUE AND COST INFORMATION FOR WALKERS LODGE

Revenue

Guest numbers:
310 chargeable guest nights from guests who stayed at the Lodge
The families each on average had 2 children, so total occupancy was 310 + 200 child guest nights = 510 guest nights.

Actual to 30 September 2013

100 families (of 2 adults with up to 3 children, who are deemed to be free in the room but are charged €5 each for breakfast) = 200 guest nights:
40 walkers on single occupancy basis = 40 guest nights
10 couples = 10 guest nights
60 business executives = 60 guest nights
Total = 310 guest nights

Rates

Average rate charged for family room (FI rate) €100 per family room per night (for a family of 2 adults and 3 children).

Note: Children (defined as those under 18 years' old, including babies) are not charged for the room and the room rate is effectively €50 per adult parent per night). However, a charge for breakfast applies to children also.

Average rate for de-luxe rooms for couples (CI rate) €40 for the room per night

Average rate for de-luxe rooms if occupied by a business executive (BI rate) €50 for the room per night irrespective of occupancy

Average rate for a single twin bedded standard room per night for walkers and backpackers (SI rate) €35 per person per night. No single supplement is charged if the room is only occupied by one person. Groups of walkers are charged based on the no. of rooms occupied, again with no single supplement.

Number of rooms

No. of family rooms (1 super king size bed + 2 single beds and baby cot)	8
No. of rooms suitable for a couple or for a business executive (1 super king size bed)	3
No. of single rooms for walkers and backpackers (two twin beds with free use of washer dryer facility in communal bathroom)	4
Total no. of rooms	15

Notes:

1. All room rates include full Irish breakfast (room rates are only charged to adult guests, i.e. those aged over 18 years old).
2. Room only rates – deduct €5 for breakfast to get the room-only rate.
3. Breakfast is charged to all guests at €5 each, so children staying with parents are charged for breakfast but are not charged for their occupancy in their parents' room.

Costs

Food costs per half year (variable with no. of guests staying)	Estimated at €3 per guest, for all guests including children staying with parents
This covers the cost of providing breakfasts in the morning and tea and coffee and homemade cookies in the lounge (all day)	
Marketing costs per half year	Fáilte Ireland's <i>Discover Ireland</i> website's fee of €1,500 per annum, plus occasional advertising by mail-shot and on UK and European travel websites/social media and in the <i>Irish Times</i> newspaper to existing guests and prospective guests costing, approximately €2,000 per half year
Energy costs per half year (mixed cost varying with x, being the no. of guests per half year occupying rooms)	€2000 + €2 x
Labour cost of cleaning and laundry cost	Done by the couple themselves for free

APPENDIX 2: THREE-YEAR FORECAST 2014–2016

Forecasted Information	2014 Six-Month Forecast	2015 Six-month Forecast	2016 Six-month Forecast
Sources of Revenue:			
<i>Breakfast</i>	Charged at €5 to non-residents attending briefing meeting with walking guide and children staying with parents on Family Rate, otherwise it is deemed to be included in the room rate		
<i>Guest Nights</i>	230	350	350
<i>Guest Mix:</i>	<ul style="list-style-type: none"> • 200 guest nights from 100 families with on average 2 children each; • 10 guest nights from walkers on single occupancy basis; • 10 guest nights from older couples on mid-week break; • 10 guest nights from business executives staying unaccompanied. 	<ul style="list-style-type: none"> • 200 guest nights from 100 families with on average 2 children each; • 130 guest nights from walkers on single occupancy basis; • 10 guest nights from older couples on mid-week break; • 10 guest nights from younger couples on weekend breaks; 	<ul style="list-style-type: none"> • 230 guest nights from 115 families with on average 2 children each; • 80 guest nights from walkers on single occupancy basis; • 30 guest nights from older couples on mid-week break; • 10 guest nights from younger couples on weekend breaks;
<i>Non-Resident:</i>	20 non-resident walkers	30 non-resident walkers	50 non-resident walkers
Estimated non-residents coming to the lodge to attend the 10 a.m. briefing meeting with the guide and taking breakfast			

APPENDIX 2 (CONTINUED)

Room Rates

FI rate	€55 per adult parent per night or €110 for the room	€55 per adult parent per night or €110 for the room	€55 per adult parent per night or €110 for the room
SI rate	€35 per room per night – no single supplement applies – but room is standard twin room	€35 per room per night – no single supplement applies	€35 per room per night – no single supplement applies
BI rate	€55 per room (deluxe room)	Business executives being phased out in favour of more walkers, families, active retired market and couples on leisure breaks	
Two-night weekend break rate (Fri to Sun) (W1 rate)	€200 per couple in special deluxe room – rate discounted to attract occupancy	€200 per couple	€200 per couple
Three-night mid-week older couple getaway rate (Tues to Thurs) (W2 rate)	€250 per couple in special deluxe room – rate discounted to attract occupancy	€250 per couple	€250 per couple

Costs

Food	10% increase per guest (including children) compared to 2013	Same as 2014 level	2014 level + 33% increase
Marketing	As per 2013	As per 2013	As per 2014 level + 10% increase in cost of annual subscription to Fáilte Ireland
Energy	A mixed cost with a decrease of 10% in the fixed element of the energy cost due to the installation of solar panels to help reduce the cost of providing hot showers and warm rooms for the guests. The variable element of the cost will show a 10% increase due to increases in gas and water rates charges.	Same as 2013 level	2014 level + 10% increase in fixed element of the energy cost due to scheduled maintenance of the solar panels.
Walking Guide	€400 per month (assume 20 days of walking in each month with three-hour slot in the morning and three-hour slot in the afternoon)	€450 per month (assume 20 days of walking in each month)	€470 per month (assume 20 days of walking in each month)
Cleaning cost	€800 per month (2 students employed on a temporary basis)	€800 per month	€800 per month